MONITORING REPORT
MUNICIPAL INFRASTRUCTURE
FINANCING PROGRAM
CZECH REPUBLIC

Prepared for:
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Municipal Finance Program

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I. INTRODUCTION AND PURPOSE OF STUDY

1.01 This semi-annual monitoring report examines progress under the Municipal Infrastructure Finance Program established by program agreement between the Government of the Czech Republic represented by the Ministry of Finance and the Municipal Finance Company (MUFIS), j.s.c., on the one side, and the Government of the United States, represented by USAID, on the other. It continues the program monitoring specified in the Program Agreement.

1.02 The Program consists of mutually supporting capital and technical assistance components. The first tranche of capital assistance, consisting of a US$20 million loan, was received by MUFIS on March 15, 1995. Technical assistance to help establish the Program and its policy objectives began in early 1993. The Program Agreement was signed May 16, 1994.

1.03 This semi-annual monitoring report reviews the Program up to December 31, 1995 with updating of some major elements to January 31, 1996. As of the dates of review, the capital component of the Program had been in effect for approximately 10 months. Technical assistance to the sector had been provided for a significantly longer period.

1.04 The Program Agreement contains a Policy Action Plan (Annex B) which spells out the policy objectives of the Program and the indicators that should be used to measure progress toward these objectives. Following the Introduction, this monitoring report is divided into four Sections, corresponding to the Program objectives:

Section II. provides a summary description of the Program's disbursement record to date, the municipal loans that have been made under the program, and the local investment projects that are being financed.

Section III. contains information on MUFIS' financial operations and the institutional capacity of MUFIS both to perform its current role and possible future functions.

Section IV. examines the aggregate development of the municipal credit market and municipal infrastructure financing in the Czech Republic. From the beginning, the Program has sought to influence the overall course of the municipal credit market, rather than to establish an isolated financing institution.

Section V. examines progress toward each of the five policy objectives specified in the Policy Action Plan, and also provides other institutional and policy information relevant to judging the Program's impact to date.

1.05 In carrying out the monitoring study, Urban Institute and Urban Research staff interviewed: (a) six of the nine banks formally enrolled in the system, including all of the banks that have approved or currently are considering loans to municipalities through MUFIS, (b) the principal commercial lender to municipalities in the Czech Republic, _eska Sporitelna, which to datals of each of the twenty three municipalities which had signed a loan agreement with participating banks as of January 31, 1996, (d) the MUFIS administrative staff, as well as members of its board of directors and supervisory board, (e) officials of the Ministry of Finance, (f) USAID officials, and (g) independent experts involved in the municipal credit sector in the Czech Republic.

II. OPERATIONAL RECORD OF THE MUFIS PROGRAM

2.01 MUFIS is a financial intermediary which borrows funds from international or domestic markets, and on-lends the funds to Czech commercial banks for the purpose of making housing-related infrastructure loans to municipalities.

2.02 The MUFIS selection of commercial banks to participate in the first round of the program was based on banks' expression of interest and their financial soundness. Since banks are obligated to repay MUFIS loans whether or not they are paid by municipalities, sound financial condition of the on-lending banks is crucial. The evaluation of banks' financial condition was based on data provided by the Czech National Bank. The criteria included capital adequacy ratios and the percentage of each bank's non-performing or classified loans. MUFIS' board of directors selected nine of the thirteen interested banks as eligible to participate in the first tranche. As of January 31, 1996, the following banks have provided loans to municipalities under the Program: Komer_ní banka, COOP banka, Pragobanka, and Investi_ní a Poštovní banka. Table 1 shows the relative size (out of the total of 57 commercial banks based in the Czech Republic), and the level of program activity of these banks.

Table 1
Actively Participating Banks

Bank	Size in CR*	Number and % of Loans	Amount in Kc(000) and % of Total
Komer_ní banka	1	6 (26%)	127,990 (29%)
Investi_ní a Poštovní banka	4	5 (22%)	71,500 (16%)
Pragobanka	9	5 (22%)	96,000 (21%)
COOP banka	19	7 (30%)	152,653 (34%)
Total		**23**	**448,143**

* Ranked by total assets.

2.03 On March 15, 1995, MUFIS received the first Housing Guaranty (HG) tranche of $20 million. After paying one-time fees and charges as specified in the Program Agreement, this amount was converted into Czech currency at the exchange rate of $1=Kc 25.928, which totaled Kc 509,705,588.

Table 2
Conversion of First HG Tranche

	Amount in		Exchange Rate*
	$	Kc	
First Tranche Amount	20,000,000		
Charges & fees**			
USAID Initial Fee (1%)	-200,000		
Investor Placement Fee	-115,000		
Paying Agent (Riggs National Bank) - one-time fee	-25,000		
Paying Agent (Riggs National Bank) - annual fee	-1,500		
Sub-Total	**-341,500**		
Net Amount Received by MUFIS	**19,658,500**	**509,705,588**	**25.928**

* Actual Exchange Rate as of the Date of Conversion
** Withdrawn on payment

2.04 **Disbursement.** As of January 31, 1996, a total of Kc 448,143,000 or approximately 88% of the total funds initially available had been disbursed. The total corresponds to twenty three underlying municipal loans. Under the terms of the Program Agreement, “disbursement” occurs at the time MUFIS transfers funds to a participating commercial bank for the purpose of financing an approved municipal loan.

2.05 The transfer of funds to participating banks occurs as follows. The bank sends an application for credit which will be used by a municipality for infrastructure investment. After conditional loan approval, the participating bank has to submit the following documents to MUFIS:

- valid credit agreement with the municipality
- valid agreement on cession.

MUFIS funds are disbursed to participating banks from MUFIS' current account maintained at CMZRB through the Czech National Bank (CNB) clearing center. All banks in the Czech Republic are electronically connected to this clearing center. MUFIS has to transfer money to the participating bank within five working days from the day when MUFIS obtains the two above-mentioned documents. It has met this timetable in all cases. The electronic transfer through CNB does not take more than 24 hours.

2.06 In addition to the 23 loans already approved by MUFIS, as of January 31, 1996 one other loan had been submitted by a participating bank to MUFIS for its final approval. Other loan applications from municipalities had been received by the banks and were being reviewed for municipal creditworthiness and eligibility under MUFIS standards. Table 3 summarizes the number and value of loans submitted to MUFIS for approval.

Table 3
MUFIS Loan Status as of January 31, 1996

Category	No. of Loans	Amount in Kc(000)
Fully Disbursed	23	448,143
Approved by Banks, Awaiting MUFIS Approval	1	7,000
Total	**24**	**Kc 455,143**

2.07 MUFIS has begun receiving principal repayments on its outstanding loans. Once MUFIS has fully disbursed its initial capital, reflows of principal will allow it to finance two additional loans of average size per year. This is possible because the external HG loan includes a grace period of ten years. Thus the principal repayments during this period can be used to finance new loans to municipalities. This “revolving fund” aspect of MUFIS will come to an end, under first tranche funding, after 10 years. All payments to MUFIS will then be needed to finance MUFIS operations and repay the HG loan.

2.08 Participating commercial banks have disbursed loan amounts to municipalities in different ways. In three cases, the entire amount of approved loan funds were transferred to the municipality, either to a special municipal account or to the municipal general (current) account. The municipality then pays construction costs from these accounts.. In this arrangement, the municipality pays interest on the entire loan amount but has the freedom to invest unexpended amounts in income-generating instruments. In another type of arrangement, banks have retained loan funds under their control until such time as construction related vouchers approved by the municipality are submitted for payment. This is the more common practice. As a result, disbursements from banks to municipalities are lower than MUFIS disbursement to the banks.

2.09 The total amount of loan funds drawn (used) by municipalities as of January 31, 1996 was Kc 303,015,800, which represents 67.6% of all funds disbursed by MUFIS to commercial banks. Three municipalities did not start to use funds in 1995 (Velké Losiny, Pr_honice, T_ebí_), since they did not sign their loan contracts until the end of 1995. Two of these municipalities had not drawn loan funds as of January 31, 1996.

Table 4
Municipal Drawdown of Loans as of January 31, 1996

Drawdown by Municipalities	No. of Loans	Amount in Kc(000)	% of MUFIS Disbursed Funds
Fully (100 %)	11	189,768	42.3
More than 50 %	6	86,490.8	19.3
Less than 50 %	4	26,757	6
Not used (0 %)	2	0.00	0.00
Total	**23**	**303,015.8**	**67.6**

2.10 Physical construction has begun on all of the twenty three projects where loans have been disbursed from MUFIS. Even in the abovementioned cases of municipalities that did not start to draw approved bank loans, construction has started and is being financed from municipal own resources. One of the conditions of the Program has been that municipalities must submit documentation at the time of loan application that they possess the necessary building permits for construction. This has narrowed the time between project approval and project start-up.

2.11 **Loan Negotiations and Loan Administration .** None of the 23 municipalities that have received loans through MUFIS reported major problems or delays in loan negotiation. Some delays in loan authorization have been encountered as a result of the requirement that a municipality obtain building permits prior to submitting its formal loan application. Although this requirement has slowed the flow of bank loan approvals, it has meant that no funds for approved loans are sitting idle awaiting project permits. On average, the bank loan approval process has taken about 3-4 months from time of initial loan contact by a municipality to final loan approval. Both banks and municipalities reported that the approval process was accelerating, as both sides become familiar with program procedures.

2.12 Several municipalities did report substantial differences between banks, and between branches of the same bank, in ability to provide information about the MUFIS program or to process loan applications. In two cases (T_ebí_, Frýdlant), the municipalities concluded their loan agreements with different branches of the same banks (COOP, KB) than where they started negotiations.

2.13 Both MUFIS and participating commercial banks have acted very efficiently in disbursing funds once a municipal loan application is approved by a bank. On average, the first municipal drawdown of funds occurred 17 days after signing of the loan contract between a municipality and bank. This period includes MUFIS approval of the loan, money transfer from MUFIS to a commercial bank, as well as bank payment to the municipality. The average period between the date a loan was approved by MUFIS and funds were disbursed to the bank was 9 days. The principal variable in this period was the time required by banks to submit the necessary documentation for funds disbursed.

2.14 In four cases commercial banks provided their own funds as a bridge loan to municipalities prior to finalizing MUFIS loan agreements. In these cases banks provided their own funds for one week on average under the same terms as MUFIS loans.

2.15 Commercial banks providing credit formerly required municipalities to switch their main current account to them, or to do other business with them as a condition of the loan agreement. There has been significant change in this regard. Nine municipalities received MUFIS loans from their main banking institution, while fourteen municipalities received loans from other than their main banking institution. Out of these 14:

(a) four municipalities were required to switch their general current account to the bank providing the MUFIS loan

(b) three were required to open a special account for the whole project including financing coming from other than MUFIS sources

(c) seven were required to establish an account for MUFIS funds only for the purpose of recording usage of the funds. In these cases the banks reserved the right to access the municipal general current account (from a different bank) in case of default.

2.16 **Future Disbursement**. At the time of interview MUFIS expected to place all of its remaining available funds during the first quarter of 1996. The disbursement rate has lagged somewhat behind MUFIS' initial projections. At the time of borrowing, MUFIS requested approval to borrow the full authorized amount of $ 20 million in one borrowing, because it foresaw the ability to disburse funds rapidly. MUFIS's original projections, made in January of 1995, were that funds would be fully disbursed within 2.5 months of receipt. This estimate was based upon banks' expressed demand for funds, which MUFIS accepted at face value.

2.17 At the time of the first interim evaluation (July, 1995) MUFIS estimated that 100 percent disbursement would be reached by the end of October, 1995. Despite the slower disbursement pace, the disbursement record compares very favorably with the norm under Housing Guaranty programs worldwide. Banks and municipalities appear to have familiarized themselves with the structure of the program, with the result that the loan application process was reported by all parties to be going smoothly.

2.18 Future demand for MUFIS funds remains uncertain. Long-term interest rates in the Czech domestic market have continued to fall, making the final interest rate at which MUFIS is able to borrow a second tranche of HG funds critical to municipal loan demand. Some of the banks participating in the MUFIS program, however, have developed special relations with regional municipalities and aggressively marketed the advantages of long-term credits. COOP banka reported that it had Kc 450 million in 26 in municipal loan projects in Moravia "ready to go" for a second tranche of MUFIS financing.[1]

2.19 At this point, the greatest uncertainty surrounding MUFIS concerns the availability, magnitude, and timing of future HG tranches. MUFIS formally requested a second tranche of $20 million. It believed that the borrowing process would take time, but that funds would be available for the Spring 1996 construction season. AID-Washington agreed to a second tranche of $10 million. However, the loan has been held up by the budget debate and related issues. Both MUFIS and participating banks have been reluctant to activate municipal demand for funds, because of the uncertainty of when (or if) funds will be available, and the fear of generating a demand for long-term credits that cannot otherwise be satisfied. This hiatus in funding threatens to jeopardize overall program operations, by leaving the impression that MUFIS is not a reliable or predictable source of financing.

2.20 **Loan Repayments.**

A. Repayments from MUFIS to U.S. investors:
Payments of interest to the U.S. investors are due semi-annually on March 15 and September 15 of each year. MUFIS made its payment of interest and periodic fees on September 15, 1995, in the amount of $836,000. The payment was made in full and on time. The exchange rate was $1.00 = Kc 27.05, reflecting a decline of 4.3% in the value of

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COOP's eligibility to participate in future HG lending is unclear. The Czech National Bank recently intervened in bank management, ordering a scaling back of the bank's aggregate lending activity.

the crown from the date of borrowing. The first repayment of principal to U.S. investors is not due until 2005.

B. Repayments from commercial banks to MUFIS:

Commercial banks repay interest to MUFIS quarterly (March 31, June 30, September 30, and December 31,) and twice a year pay loan principal (June 30, and December 31). As of January 31, 1996, banks had paid to MUFIS a total of Kc 12,093,377 in interest, and Kc 3,858,700 in principal repayments on 5 loans. All interest and principal payments by commercial banks to MUFIS were made in full and on time. From the 23 loans provided to date, MUFIS will receive in 1996 approximately Kc 73 million in interest and principal payments. The portion of these funds corresponding to principal payments will be available for re-lending.

C. Repayments from municipalities to commercial banks:

The repayment schedule of individual loans by municipalities is a subject of negotiation between a given bank and a municipality. The frequency of payments vary case by case for both interest and principal.

(i) Repayments of principal:

Arrangements range from two principal payments per year (9 loans), to quarterly payments (13 loans) to monthly repayment (1 loan). Most common are equal principal installments (19 loans). In some cases the amount of principal repayment changes over time (4 loans); typically, this involves increasing principal payments so as to maintain fixed total payments (principal plus interest). There has been only one case - City of T_ebí_ - in which a commercial bank agreed to grant a grace period on principal repayment as part of the original loan terms. City of T_ebí_ negotiated this arrangement with COOP Bank based on the planned construction progress of its project and the expected stream of project revenues.

(ii) Interest payments:

Municipalities pay interest to commercial banks either quarterly (11 loans) or monthly (12 loans). Interest due is calculated from the actual amount of the loan that has been drawn. Interest payments by municipalities totaled Kc 8,085,000 as of December 31, 1995. This is approximately Kc 4 million less than the commercial banks had to pay MUFIS, since banks have the obligation to pay interest to MUFIS on the whole amount of the loan beginning from the date of transfer of funds from MUFIS to a bank. (The bank is free to invest undisbursed funds in short-term money instruments.)

2.21 Bank payments to MUFIS are handled in reverse order from MUFIS disbursements. Payment of interest and principal have to be received within 5 working days of the scheduled due date. Transfers are made from the account of a participating bank through the CNB clearing center to MUFIS' general current account at CMGDB.

III. MUNICIPAL INVESTMENTS

3.01 **Underlying Municipal Loans and Project Investments**. As part of the Monitoring, the consulting team investigated the loan arrangements between lending banks and borrowing municipalities, as well as the underlying municipal investment projects, for the 23 loans that had been disbursed by MUFIS as of December 31, 1995.

3.02 For each of the 23 loans, one or more members of the assessment team visited the borrowing municipality and interviewed the mayor, other key members of the municipal administrative staff, including budget officers and those responsible for implementing the investment project, and, in most cases, loan officers of the branch of the bank responsible for loan negotiations with the municipality.

3.03 The tables and comments below provide an overview of the investment projects that are being financed through MUFIS loan activity. Annex A describes the individual loans and investment projects.

3.04 **Size of Borrowing Municipality**. MUFIS funds have been used by the participating banks to finance loans primarily for small and medium-sized municipalities. This is consistent with program objectives. The few large cities in the Czech Republic have access to the credit market without the intermediation of MUFIS. A principal rationale for the development of MUFIS was to increase credit availability for the great bulk of municipalities, which have populations under 10,000. [Only 284 of the 6,230 municipalities in the Czech Republic have a population over 5,000]. Table 5 provides a breakdown of loan activity by municipal population size.

Table 5
MUFIS Loans by Municipal Population

Population Size	Number of Loans		Total Amount	
	No. of Loans	in %	in Kc(000)	in %
Less than 5,000	11	47.8	147,500	32.9
5,000-10,000	7	30.5	179,360	40.0
10,000-20,000	2	8.7	36,783	8.2
20,000-50,000	1	4.3	40,000	8.9
50,000-100,000	2	8.7	44,500	9.9
100,000 and over	0.00	0.00	0.00	0.00
Total	**23**	**100.0**	**448,143**	**100.0**

3.05 **Regional Distribution**. Loans have been distributed throughout the entire country. Table 6 shows the distribution between Bohemia and Moravia-Silesia. The Program Agreement stipulates that a minimum of 75% of loan activity will take place outside of Prague. To date all twenty three MUFIS loans have been made outside of the City of Prague. [Note that the demarcation between Moravia and Silesia is not completely clear, because “regions” are not legally defined in the Czech Republic. However, by conventional regional groupings, 7 loans have gone to Bohemia, 9 to Moravia, and 7 to Silesia.]

Table 6
MUFIS Loans by Region

By Region	Number of Loans		Total Amount	
	No. of Loans	in %	in Kc(000)	in %
Bohemia	7	30.4	162,990	36.0
Moravia-Silesia	16	69.6	285,153	64.0
Total	**23**	**100.0**	**448,143**	**100.0**

3.06 **Loan Maturity**. The Program Implementation Plan allows loans ranging from 7 to 15 year maturity. Table 7 shows that the loans made so far have been at the longer end of the maturity options. Thirteen of the twenty three loans representing 68.6% of the disbursed amount have been for 14 -15 years, the longest period allowed under the Program Implementation Plan. These MUFIS loans are the longest-term municipal loans that have been made in the Czech Republic. They directly support the program objective of lengthening municipal lending periods, in order to provide a more stable and more affordable basis for infrastructure financing. As shown in Table 7, another group of ten loans (or 31.4% of total lending) was provided for 10 - 11 years. This type of maturity is still very scarce in the Czech Republic.

Table 7
MUFIS Loans by Maturity

By Maturity	Number of Loans		Total Amount	
	No. of Loans	in %	in Kc(000)	in %
Less than 10 years	0	0.00	0.00	0.00
10-11 years	10	43.5	140,653	31.4
12-13 years	0	0.00	0.00	0.00
14-15 years	13	56.5	307,490	68.6
Total	**23**	**100.0**	**448,143**	**100.0**

3.07 **Interest Rates.** MUFIS rules place a ceiling of 2.5 percentage points on the margin that banks can add to their cost of capital from MUFIS in municipal lending. Under the first tranche of funding, banks borrow funds from MUFIS at 9.5%. The ceiling rate for on-lending therefore is 12%. As can be seen from Table 8, all loans have been within this ceiling. Competition between banks has resulted in many loans and approximately half of the approved lending amount being made at rates below the authorized ceiling. This is one of the benefits of using MUFIS to encourage competition among potential lenders. Bigger cities were more likely to receive interest rates below the ceiling. For example, the two 11% loans were made to the two largest cities in the program, Pardubice and Opava.

Table 8
MUFIS Loans by Interest Rate

Interest Rate	Number of Loans		Total Amount	
	No. of Loans	in %	in Kc(000)	in %
11%	2	8.7	44,500	9.9
11.5%	7	30.5	148,153	33.1
11.75%	1	4.3	25,000	5.6
12%	13	56.5	230,490	51.4
Total	**23**	**100.0**	**448,143**	**100.0**

3.08 **Type of Collateral**. One of the program objectives has been to encourage banks to move away from exclusive reliance on municipal property as collateral for municipal loans. Heavy reliance on property collateral (i) limits municipal use of credit since a municipality´s borrowing capacity is constrained by its tangible property holdings; (ii) restricts a municipality´s economic development and other options since property offered as collateral cannot be sold to third parties and cannot be modified without bank approval; and (iii) diverts attention from the most important factor in municipal ability to pay - the adequacy of future income streams to service debt obligations.

3.09 Formal, legal dedication of future revenue streams as collateral for debt repayment appears not to be possible under Czech law, which recognizes only currently owned assets as possible collateral. A municipality can promise to repay loans from available future revenues, but the preponderance of legal opinion holds that this contract is not enforceable in the Czech courts -- i.e., it would not be possible for the creditor to seize future revenue streams in the event of non-payment. This provision of Czech law makes strict “revenue bond” financing impossible. Every loan in the Czech Republic is in effect a “general obligation” of the borrowing municipality, though the repayment commitment may be strengthened by the promise to use project revenues to pay off debt. Since there have been no cases of default on municipal loans or municipal bonds, the exact position the courts would take on “promises” contained in loan documents in the event of default remains unclear.

3.10 Table 9 shows the principal security behind MUFIS loans. Only four of the twenty three loans have been secured solely by municipal property. Five of the loans are supported by future revenue streams, without additional collateral. In addition, four of the twelve "Combined" types of collateral did not require pledging of municipal real property. Prior to 1995, essentially all municipal loans in the Czech Republic were secured by property collateral.

Table 9
MUFIS Loans by Type of Collateral

Type of Collateral	Number of Loans		Total Amount	
	No. of Loans	in %	in Kc(000)	in %
Current Account*	2	8.7	57,000	12.7
Municipal Property	4	17.4	64,630	14.4
Municipal Future Revenues only	5	21.7	81,653	18.2
Combination	12	52.2	244,860	54.7
Total	**23**	**100.0**	**448,143**	**100.0**

* The bank has the right to claim funds held in the municipal current account in the event of default.

3.11 **Debt Service.** Municipalities in the Czech Republic tend to carry low debt burdens. Prior to 1992, municipal debt was virtually non-existent. The introduction of the new tax system and major changes in municipal finance in 1993 enabled municipalities to adopt their own investment and capital financing policies. The municipal credit market started to emerge. Yet, Czech municipalities generally maintain conservative and prudent borrowing practices. This conservatism is reflected in borrowing through the MUFIS program. Table 10 shows the relatively low rate of debt service as a percentage of total municipal revenues for both MUFIS loans and all debt service of participating municipalities. Despite the generally modest-to-moderate levels of debt service, some of the municipalities face future increasing debt service burdens because of Environmental Fund loans. These loans carry no interest charges and now include five-year grace periods on principal repayment. When principal payments start to become due, debt service costs will jump significantly. This situation deserves close monitoring.

Table 10
Annual Debt Service for Borrowers under MUFIS Program - 1996
(Debt Service as % of Municipal Revenues)

%	No. of Municipalities	
	MUFIS Program Loans	All Debt Service
0 - 1.0	2	0
1.1 - 2.0	3	0
2.1 - 3.0	0	0
3.1 - 4.0	2	4
4.1 - 5.0	3	6
5.1 - 6.0	1	1
6.1 -7.0	1	1
7.1 - 8.0	2	1
8.1 - 9.0	4	3
9.1 - 10.0	0	1
10.1 -11.0	3	4
11.1 - 12.0	0	0
12.1 - 13.0	0	0
13.1 - 14.0	0	0
14.1 - 15.0	2	2
more than 15.0%	0	0
Total	**23**	**23**

3.12 **Municipal Investment Projects** . MUFIS loans have been used for a wide variety of project purposes. Municipalities have covered all or part of the financing of 35 separate projects from 23 loans. Table 11 summarizes the principal investment activities being financed. However, some of the loans are being used for related investment projects, making a strict classification of loan purpose difficult (e.g., “comprehensive reconstruction”). Environmental investments loom large in the overall financing picture. Given the large backlog of local environmental needs, this use of MUFIS funds would appear to fit national priorities. Most of the projects have a positive environmental impact. In some cases the projects’ impact on pollution reduction is directly measurable (waste water treatment, sewer systems); in other cases the effects are more indirect (energy savings from building insulation or installation of metering devices).

Table 11
Municipal Projects Financed with MUFIS Loans

Primary Purpose	Number of Projects*		Total Loan Amount	
	No. of Loans	in %	in Kc(000)	in %
Metering and Control Devices (heating)	3	8.6	33,653	7.5
Water Distribution	5	14.3	34,086	7.6
Sewer Collection	6	17.1	90,603	20.2
Comprehensive Infrastructure Reconstruction	6	17.1	79,468	17.7
Gas Distribution and Energy Conversion**	11	31.4	94,973	21.2
Co-Generation for Residential Heating	2	5.7	85,360	19.1
Solid Waste Landfill	1	2.9	12,000	2.7
Building Insulation	1	2.9	18,000	4.0
Total	**35**	**100.0**	**448,143**	**100.0**

* As measured by number of separate building permits.
** Conversion from coal to natural gas heating.

3.13 **Housing Related Components**. Under the Program Agreement, investment projects financed through the HG loan must be housing related. Table 12 summarizes the housing-related share of total project investment for the 23 loans.

Table 12
Housing-Related Share of Total Project Investment

% of "Housing Related" Project Components*	Number of Loans		Total Amount	
	No. of Loans	in %	in Kc(000)	in %
50-69%	3	13.0	76,000	17.0
70-90%	15	65.2	292,860	65.3
more than 90%	5	21.8	79,283	17.7
Total	**23**	**100.0**	**448,143**	**100.0**

* % of investment total

3.14 The impact of projects on the local population is illustrated by Table 13. In all, the projects serve 35,400 households with a population of 124,000 people. The water, sewer, and landfill projects have served essentially the entire local populations. Other projects have concentrated on re-building portions of a town, or providing more energy-efficient heating for clusters of individual housing projects.

Table 13
Households Benefiting from Projects

Project Type	Number of hold Benefi	Population Benefiting	% of Total Municipal Population Benefiting[a]
Metering and Control Devices	6,20	21,700	35%
Water Distribution	3,00	10,500	92%
Sewer Collection	8,45	29,575	100%+[b]
Comprehensive Infrastructure Reconstruction	6,15	21,525	27%
Gas Distribution and Conversion	3,26	11,410	60%
Co-generation for Residential Heating	1,75	6,125	38%
Landfill	6,60	23,100	100%+[c]
Total	**35,41**	**123,935[d]**	**N/A**

a. Mean % for all towns (not population-weighted).
b. Two projects serve neighboring municipalities, as well.
c. Serves neighboring areas.
d. Households served by more than one project are counted once only.

3.15 **Project Cost Recovery**. The Program has the objective of encouraging greater cost recovery in municipal investment projects -- i.e., the recovery of at least a significant portion of project investment costs through fees and charges levied on users or beneficiaries. This kind of pricing reduces the pressure of borrowing on the overall municipal budget, makes possible a higher level of local investment activity, and apportions costs to those who benefit most substantially from project investment. Of course, full cost recovery from users is inappropriate in many cases. In particular, environmental projects often produce area-wide benefits that make them appropriate to finance in part through general tax revenues or central government subsidies.

3.16 Municipalities have been most likely to recover part of their investment costs through user fees when the utility system that owns the property has been completely turned over to municipal ownership. Otherwise, the municipality does not fully control fee-setting, and it may not receive direct financial benefits from higher fees. Full investment cost recovery has been most common on projects involving the installation of metering devices. Investments in landfills, water and wastewater projects also show a significant percentage of cost recovery. Heating conversion projects and projects to extend gas distribution lines provide mostly environmental benefits. They have had a low rate of direct cost recovery, or none at all.

3.17 Table 14 shows the estimated cost recovery rate for projects financed by the 23 MUFIS loans. In most cases city officials have made projections of future operating costs as well as future project revenues, permitting calculation of the extent of planned recovery of investment costs. The cost recovery estimation period has been somewhat arbitrarily limited to eight years. Projections of costs and revenues beyond that span are inherently uncertain.

3.18 Why have cost recovery rates been relatively low? First, Czech municipalities have enjoyed robust growth from general revenues. As a group, they have been able to finance rising investment shares and still maintain budget surpluses. They have not faced significant fiscal pressure to recover capital costs in order to sustain investment levels. Second, there is intense citizen opposition to fee increases. Fees for water service, wastewater collection and treatment, and residential heating already have risen at very steep rates because of price de-regulation. Municipal authorities have been reluctant to add capital cost recovery to the fee structure. Finally, institutional arrangements weaken the incentives municipalities might otherwise have to raise fees. Gas distribution, for example, is provided by an independent company. The gas company collects all charges. A special arrangement would have to be negotiated to include in the gas bill a fee that repays the municipality for the capital costs incurred in extending gas lines. A similar situation is found in many regional water companies. These are owned collectively by a number of municipalities, and serve a regional customer base. Special arrangements have to be negotiated for a single municipality to recover through water tariffs the capital costs incurred to upgrade or extend the local water distribution system.

Table 14
Estimated Capital Cost Recovery

Estimated Project Cost Recovery over 8 Years of Operations	Number of Loans	Total Value in Kc(000)	%
0 %	5	71	15.8
1 - 50 %	9	193	43.1
51 - 75 %	3	42	9.4
76 - 100 %	6	142	31.7
Total	**23**	**448**	**100**

3.19 **Sources of Project Financing .** Most municipalities are using more than one source of financing for their infrastructure projects. Given the complexity and interconnections within the systems of municipal infrastructure, it is often difficult to determine if a given construction is a part or stage of a bigger project or if it should be viewed as a stand-alone project. Consequently, it can be difficult to isolate the MUFIS share of overall project financing. In addition to MUFIS loans, 15 projects were financed by municipal own-resources in the range of 5 to 30% of construction costs. The State Environmental Fund co-financed 8 projects, and the Ministry of Agriculture co-financed 4 projects. The Ministry of Finance and Ministry of Culture co-financed one project each. In three cases a group or association of municipalities complemented the MUFIS loan with own resources. In one case, the MUFIS loan was supported by additional financing from the local business community.

IV. INSTITUTIONAL CAPACITY OF MUFIS AND ITS FUTURE ROLE IN THE MUNICIPAL CREDIT MARKET

4.01 One of the principal objectives of the Municipal Infrastructure Finance Program has been the creation or strengthening of institutional capacity throughout the municipal credit market. The technical assistance strategy for training commercial banks in credit analysis, and collaborating with Parliament and government ministries on policy reforms, has been described in other reports. This report examines the institutional capacity of the Municipal Finance Company, MUFIS.

4.02 **MUFIS - Municipal Finance Company .** Based on authorization by the Czech Government represented by the Ministry of Finance (MoF), MUFIS was founded by the Czech and Moravian Guaranty and Development Bank (CMGDB) with an initial capital of Kc 1 million and registered as a joint stock company according to the Czech Commercial Code in April, 1994. Subsequently, the shares were transferred in March 1995 to reflect MUFIS' current ownership. Major shareholders are MoF and CMGDB which own 49% each. The third shareholder is the Union of Towns and Communities (UTC) of the Czech Republic which owns the remaining 2%. Upon registration, MUFIS became the bearer of the Czech Government guaranty of up to $100 million in Housing Guaranty loans. This amount represents the maximum amount of funds that can be provided to the Czech Republic over five years under this Guaranty.

4.03 MUFIS has a Board of Directors which oversees administration, and a Supervisory Board, which sets policy. The boards consist of representatives from MoF, CMGDB, UTC, Ministry of Economy (MoE), and municipal governments as well as independent experts on municipal finance.

4.04 MUFIS’ role in a broader sense is to support a self-sustaining, market-based credit system to finance municipal infrastructure in the Czech Republic, as specified in the Policy Action Plan of the Program Agreement. The role of MUFIS in a narrower sense with respect to HG funds is twofold: (a) to solicit and receive funds from U.S. investors who are guaranteed by USAID under its Housing Guaranty Program, (b) to make loans to participating financial institutions -- at this point, commercial banks -- which on-lend to municipalities for eligible infrastructure projects. MUFIS thus is a specialized financial intermediary. Its role is illustrated in Figure 1.

4.05 **MUFIS' Financial Operations.** MUFIS started financial operations in March, 1995 by receiving $20 million as the first tranche HG Loan. Its financial operations have included: (a) receiving and converting into Czech currency the first tranche of $20 million, (b) payment of interest to the U.S. investor on September 15, 1995,

(c) disbursing funds by providing loans to participating commercial banks, (d) receiving payments of interest and repayments of principal from participating commercial banks, (e) management and placement of undisbursed funds.

4.06 MUFIS' fiscal year is a calendar year starting January 1 and ending December 31. The Preliminary Profit and Loss Statement for 1995 indicates a loss in the amount of Kc 11.9 million. The full Preliminary Profit and Loss Statement is shown in Table 15.

Figure 1

Table 15
Preliminary 1995 Profit and Loss Statement of MUFIS, Inc.

Item	1995 Expenses	Kc(000)
1	One time fees and charges on loan delivery (time adjusted)	223
2	Periodic charges to USAID and Riggs National Bank	2,057
2a	of which: periodic charges paid	1,392
2b	periodic future charges (time adjusted)	665
3	Interest payments to U.S. investor	33,732
3a	of which: interest payments realized	22,612
3b	future interest payments (time adjusted)	11,120
4	Foreign exchange loss incurred	6,527
5	Reserve for foreign exchange loss	0.00
6	Charges for services of external companies	5,566
6a	of which: auditor	105
6b	accounting company	176
6c	CMGDB	255
6d	other	20
7	Other expenses	113
8	Allocation to foreign exchange loss fund	318
9	Allocation to cash-flow risk fund	127
10	**Total Expenses**	**43,653**
	1995 Revenues	
11	Interest on short-term financial investment (after 25%withholding tax)	19,445
12	Interest on provided credits (not subject to withholding tax)	12,093
13	Charges levied on bank contracts	185
14	Other revenues (bank current account interest before tax)	23
15	**Total Revenues**	**31,746**
16	**Profit / Loss of Current Year**	**-11,907**

Note Some of the data in this table differ from the data for similar entries in Table 2. Table 2 is a cash balance accounting. Table 15 allocated one-time fees and other costs over time periods according to Czech accounting conventions.

4.07 The significance of the reported loss in 1995 is subject to different interpretations. The major factors contributing to the loss were:

- MUFIS was established legally as a financial institution, but not as a bank. Under Czech law, it is subject to income withholding tax on interest earned on short-term investments, even when MUFIS reports an overall loss. In 1995, Kc 6.48 million was paid as income tax, equivalent to more than half the reported loss.

- MUFIS suffered from unfortunate timing in its HG borrowing. A delay in preparation of loan documentation forced a one-month postponement in the loan closing date. Although the Czech crown has held steady in value for the past three years, and in fact has appreciated modestly against the dollar, the volatility of U.S. markets in March of 1995 was such that MUFIS ended up borrowing at a rate near the 1995 peak of U.S. interest rates and near the year´s low for the value of the Czech crown. This resulted in higher-than-expected interest costs, as well as a currency exchange loss of Kc 6.527 million, measured as the increase in the crown equivalent of the $20 million external debt, between the date of borrowing and the end of the fiscal year. Although most of this loss was not a cash loss, Czech accounting practices require that the full amount be recognized in the Profit and Loss statement.

- Czech law requires rapid amortization of one-time fees. The original financing plan submitted by MUFIS with technical assistance from Riggs National Bank called for amortizing one-time fees over a period of 30 years. However, Czech accounting rules do not allow amortization periods of more than four years. The higher costs to MUFIS in the first four years will be offset in later years, once the fees have been fully amortized.

- MUFIS disbursed funds to participating banks more slowly than anticipated in its initial financial plan. It thus had larger cash balances than anticipated. It also earned lower after-tax rates than projected on its short-term investments, partly because it did not avail itself of the tax-free investment opportunities recommended by Riggs. This led to a shortfall in interest earnings.

4.08 Overall, MUFIS revealed a relatively weak capacity for financial management in its first year. Its short-term investments could have been structured as floating rate short-term loans to CMGDB or another investor, so as to have avoided income withholding tax liability. This policy was recommended by Riggs National Bank in its technical assistance reports to MUFIS, but not adopted. The structure of "frame limits", under which different banks indicated the amounts they intended to borrow from MUFIS and corresponding funds were reserved for them, took a long time to negotiate and in the end proved unhelpful. Several banks did not utilize their planned lines of credit. The effort that went into negotiating the "frame limits" could have been more productively directed at encouraging banks to present loan projects and financing them on a first-come, first-served basis.

4.09 MUFIS' financial management was hampered by the lack of a clear policy statement regarding cash management. The Financial Plan submitted by MUFIS, and prepared with technical assistance from Riggs National Bank, assumed that MUFIS would maximize its after-tax earnings on disbursed funds, subject to safety considerations. Although the investment of cash on hand was discussed at several Supervisory Board meetings, the Supervisory Board never formulated a policy regarding cash management.

4.10 The technical assistance plans for MUFIS management and MUFIS financial procedures prepared by Riggs National Bank and Beckett Consulting recommended creation of three full-time positions. One was a cash manager, whose responsibility would be to manage short-term cash investments so as to maximize returns and assure availability of cash when needed for lending activities. The other two positions were a Program Director, who would oversee MUFIS general development, and an Account Officer, responsible for enacting and monitoring all cash transactions.[2]

4.11 These recommendations were not implemented. One reason was the cost of full-time positions. All of the original management planning was based on the assumption that there would be a smooth expansion of the Program to US$100 million, as long as there was bank and municipal demand for loans. As it has become clear that USAID financing would fall short of the $100 million goal, it has become important not to saddle MUFIS with a permanent, high-cost administrative structure. The staffing organization that would have been cost- effective in managing a $100 million portfolio is far too large and costly to manage the $20 or $30 million portfolio that now seems more likely. CMGDB personnel have performed the functions described above, as part of CMGDB's management agreement.

4.12 MUFIS has agreed to make important modifications in cash management during 1996. In particular, cash on hand will be invested as current account deposits tied to the interbank lending rate, without income tax liability, and the "frame limits" method

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Riggs National Bank, Strategic Cash Management Review (April 4, 1995); Beckett Consulting, Tactical Cash Management Review (March 7, 1995).

of establishing credit lines will be abolished. The coming year therefore should present a more thorough test of MUFIS' ability to operate with acceptable annual losses.

4.13 The magnitude of the first-year operating loss has led to extensive discussions between MUFIS and the Ministry of Finance as to how much of the loss should be reimbursed to MUFIS by the MoF. As of the date of report preparation, this issue remained under discussion.

4.14 Looking to the future, MUFIS' spread on the first-tranche funds, even when these are fully lent to participating banks, is slim. As shown in Figure 1, the difference between MUFIS' cost of funds and its on-lending rate is only 0.44%, excluding potential foreign exchange losses. The Ministry of Finance has agreed to absorb the cost of foreign exchange losses, should these occur. However, MUFIS must pay for all its operating costs from the spread. A spread of 0.44%, applied to a $100 million loan portfolio, would generate $440,000 per year of income, more than ample to cover the costs of a full personnel complement for MUFIS as well as other operating costs and a contribution to reserves for currency depreciation. However, the same spread applied to a portfolio of $20 million generates only $88,000 of potential income.

4.15 **MUFIS' Institutional Structure and Capacity .** MUFIS' governing bodies are: the Shareholders' General Assembly, the Supervisory Board and the Board of Directors. Powers, responsibilities and interaction among these bodies are governed by the company's Charter.

4.16 The Shareholders' General Assembly is the supreme governing body of the company. It meets annually. Upon informing the Supervisory Board, the Board of Directors can convene an extraordinary general assembly meeting in addition to the regular one.

4.17 The Supervisory Board oversees the company's activities and approves MUFIS' strategies and policies. It consists of seven members elected by the General Assembly for a three-year term. The Supervisory Board appoints and confirms members of the Board of Directors. According to the Charter, Supervisory Board meetings are convened by its Chairman at least once a month. Members of the MUFIS' Supervisory Board are registered in the Commercial Court's Register. Mr. Macka, General Director of CMGDB, a 49 percent shareholder, is Chairman. The representative of the Ministry of Finance, also a 49 percent shareholder, Ms. Kameni_ková, acts as Deputy Chairman.

4.18 In 1995, the Supervisory Board held 13 meetings and carried out numerous activities relevant to the first year of MUFIS' operation and the first HG tranche. While having top government officials as members of the Board (Deputy Minister of Finance, Deputy Minister of Economy) gives MUFIS a high reputation, their frequent unavailability for attending the Board's meetings resulted in increased work loads for other members, and in narrowing the range of opinions on issues that came before the Board. The Supervisory Board has established few written policies, which has led to some disagreements and confusion as to what MUFIS policies are on such key matters as cash management, payment of CMGDB management fees, or receipt of operating subsidies from the MoF.

4.19 The Board of Directors manages and acts on behalf of MUFIS in executing General Assembly resolutions, and in carrying out Supervisory Board policies and decisions. It consists of five members appointed by the Supervisory Board for three-year terms who meet according to the Charter at least once a month. As MUFIS' executive body, the Board of Directors should be responsible for supervising individual contractors and ensuring the quality of services that MUFIS provides.

4.20 MUFIS does not have any employees. All functions are carried out through external contractors. General administration, banking, and financial services, including cash management, are provided by CMGDB under a fee arrangement. All financial accounts are maintained at CMGDB. The technical assistance recommendations to create three full-time positions were not implemented.

4.21 In its first year, MUFIS suffered from the lack of clear or written understandings between it and its two major shareholders, CMGDB and Ministry of Finance, and from the lack of regular staff. The large amounts of cash held by MUFIS during Year 1 were placed on deposit principally with CMGDB, under terms which did not compare favorably with inter-bank lending rates. The lack of aggressive cash management by MUFIS penalized its earnings while benefiting CMGDB which was acting as cash manager.

4.22 MUFIS has taken steps to spell out more clearly the cash management procedures it will follow in 1996. Its understanding with CMGDB will both tie interest rates on MUFIS cash holdings more closely to the inter-bank rate (PRIBOR), and invest cash so that the proceeds are not liable to income tax withholding. In the absence of a written agreement between MUFIS and CMGDB, however, misunderstandings are likely to continue. It therefore should be a priority to establish a written agreement covering cash management policy and to monitor implementation of this policy.

4.23 The importance of having clear, written policies is illustrated by our interviews with MUFIS and CMGDB personnel regarding cash management. Two members of the Supervisory Board believe that the Board instructed MUFIS to invest its cash holdings as short-term loans to CMGDB at the rate of PRIBOR - 1%, and that this policy was agreed to by CMGDB. It would exempt MUFIS from tax withholding on interest earned. However, the individual at CMGDB acting as cash manager for MUFIS affirms that the Supervisory Board has instructed him to invest cash only in fixed-rate term deposits. There is no written record of any kind of Supervisory Board actions.

4.24 The absence of a written agreement between MUFIS, the Ministry of Finance, and CMGDB produced disagreement between shareholders as to how MUFIS´s losses in Year 1 would be covered. To avoid similar uncertainty in 1996, a written agreement between MUFIS and MoF covering MoF´s financial commitments would be desirable.

4.25 CMGDB staff acting on behalf of MUFIS have efficiently and expeditiously processed bank loan applications, and handled paperwork review. This aspect of the system is running more smoothly than could be anticipated for the first year of a new institution.

4.26 Without a professional staff MUFIS has extremely limited capacity to conduct financial or credit analysis. Unless it obtains external assistance, this will restrict its ability to assume credit risks (e.g., through direct purchase of bond issues) or to expand the range of its financial operations in other ways. To date, MUFIS has accepted assistance from USAID to prepare legal documentation and to conduct financial assessment of HG loan offers. This assistance will be offered for the second tranche of HG lending as well. At some point in the future, however, these and similar functions will have to be performed either by MUFIS staff or by other organizations under contract to MUFIS.

4.27 MUFIS´ long-run goals as an institution, and the capabilities it requires to achieve these goals, need to be identified more clearly. Various visions of MUFIS' longer-term role have been proposed. These range from having MUFIS become a permanent financial intermediary, obtaining capital funds for on-lending from international organizations and the domestic capital market, to phasing out MUFIS in view of the private market's increasing capacity to finance municipalities' borrowing needs. The shareholders of MUFIS need to express a clear sense of MUFIS’ mission. The MUFIS Supervisory Board has endorsed a plan proposed by the Chairman to prepare a three-year business plan, for discussion with the Ministry of Finance and potential external lenders, by the end of June 1996. This business plan will be critical to MUFIS´ institutional evolution.

4.28 USAID also needs to clarify its commitment to MUFIS. The uncertainty over future HG funding has not only disrupted MUFIS' financial planning, but has disrupted MUFIS' institutional development. MUFIS' planning was premised on the Government's commitment to guaranty $100 million of borrowing by MUFIS under the HG program. The Government so far has indicated that it will not attempt to extend this guaranty to other lenders. (The Government guaranty is limited to HG loans; a new proposal would have to be prepared by cabinet and approved by Parliament within the global guaranty ceiling, for a guaranty to be extended to other lenders.) It has proved difficult even to formulate options for MUFIS' future with so much uncertainty regarding HG capital funding.

4.29 Whatever decision is made about MUFIS' future, preparation for transition to a new permanent role should begin very soon, while USAID-funded technical assistance is still available. Any re-definition or expansion of MUFIS' role will require substantial preparation. Even a reduction in MUFIS' planned scale of operations will require re-negotiating fee arrangements with CMGDB and planning for the re-investment of MUFIS re-flows on a scaled-down basis.

V. THE MUNICIPAL CREDIT MARKET AND MUNICIPAL INFRASTRUCTURE FINANCING

5.01 The Municipal Infrastructure Financial Program has sought to help establish a workable municipal credit market in the Czech Republic. The ultimate test of its success is the way that market performs.

5.02 Prior to 1992, municipal borrowing to finance local infrastructure projects was virtually non-existent. The system inherited from the previous regime made municipalities almost totally dependent on central authorities. Over 70% of local revenues came from the state budget, and almost all local capital investments were financed by state subsidies or state grants, respectively.

5.03 With progress in decentralization and the deepening of democratization in the Czech Republic, a new tax and local government financing system was adopted beginning January 1, 1993. This reform eliminated many of the traditional central subsidies for local government, and replaced them with shared tax revenues, treated as "own source" revenues in the Czech (and EU) public accounting system. Shared taxes are centrally collected and then apportioned to local budgets. Table 16 shows the shared taxes and the ratio allocated to municipal governments for each tax. As part of the finance reforms taking effect in 1996, a greater proportion of centrally collected revenues are distributed on the basis of local expenditure requirements, rather than point of revenue generation.

Table 16
Shared Taxes as Municipal Revenues

	1993	1994	1995	1996
	%	%	%	%
Personal Income Tax	40	50	55	30
Unincorporated Income Tax	100	100	100	100
Corporate Income Tax	0	0	0	20
Property Tax	100	100	100	100

5.04 Another source of municipal own revenue is represented by local fees. Municipalities are authorized by law to impose the following six local fees: dog fees, fees on spa or recreational stays, facility bed charges, fees on using public space, fees on entrance charges, fees on car permits to enter certain parts of municipalities. Local fees are collected by the municipality. They account in total for only 1.5 % of municipal revenues. They are more important for small municipalities.

5.05 **Municipal Credit.** There are very few restrictions on municipal borrowing in the Czech Republic. The law enables municipalities to enter both the domestic and foreign loan markets without any restrictions concerning either the purpose for which the municipality wants to borrow, or the structure of a loan, including the date of maturity and the interest rate. To issue bonds, a municipality has the obligation, like all other subjects, to apply for an issue permit at the Ministry of Finance and the Czech National Bank. The national government review is primarily for the legal form of bond issues, but also includes a judgment as to whether bond issuance is financially prudent. In addition to legal flexibility, the stability and predictability of municipalities' shared tax revenues have given them considerable financial latitude in taking on debt.

5.06 The legal and financial system established by the Czechs has created favorable conditions for a municipal credit market to emerge. However, a number of impediments inherited from the previous system had to be dealt with. A single institution handled the overwhelming majority of municipal loans and individual savings deposits. There was very little recent experience with long-term or even intermediate-term lending for municipal investment. Most municipal loans were short-term bridge loans to cover cash shortfalls. There were no municipal bonds, and no activity in the municipal sector by foreign banks. The primary policy goals of the Municipal Infrastructure Financing Program have been to inject competition into the municipal credit market, and to improve the conditions of municipal borrowing for infrastructure investment, e.g., lengthening the terms of loans, lowering interest rates, and improving collateral conditions.

5.07 Access to long term capital is crucial to successful financing of infrastructure projects and is one of the criteria for measuring effectiveness of a credit market. The Czech National Bank defines “long term” loans as loans of four-year maturity or greater, “medium term” as loans of one to three years, and “short term” as loans shorter than one year. As shown in Table 17, the total amount of commercial loans granted to municipalities on the domestic loan market has been constantly increasing since 1993. Municipal loan volume increased almost four times between December 1993 and December 1995.

Table 17
Volume and Term Structure of Municipal Commercial Credit Outstanding

Type of Credit	December 31, 1993		December 31, 1994		December 31, 1995	
	Kc(000)	%	Kc(000)	%	Kc(000)	%
Short term[a]	632,960	31.8	769,244	18.2	1,802,455	24.6
Medium term[b]	818,761	41.3	1,663,129	39.4	1,916,579	26.1
Long term[c]	532,661	26.9	1,790,081	42.4	3,611,176	49.3
Total	**1,983,382**	**100.0**	**4,222,454**	**100.0**	**7,330,210**	**100.0**

a. Less than one year.
b. 1 - 3 years.
c. 4+ years.

5.08 The aggregate shift in the structure of municipal commercial debt from short and intermediate term to long term has been impressive. The share of long-term loans in total municipal debt increased from 27% at the end of 1993 to almost 50% at the end of 1995. The share of both short-term and intermediate-term debt fell during this period. The lengthening of loan maturity provides a more stable basis for infrastructure financing and alleviates the threat of a financial crisis resulting from municipalities' inability to roll over short-term debt. Unfortunately, no data are available regarding the total volume of loans of seven or ten years' maturity or longer, which would be considered long-term in the United States or Western Europe.

5.09 MUFIS' role in overall credit market development can be judged in relation to the aggregate data shown in Table 17. MUFIS accounted for a small share -- about 15% -- of the net increase in municipal lending during 1995. However, it accounted for a larger share of its intended market. Bank loans through MUFIS accounted for 25% of net "long-term" lending (4 years maturity or longer) in 1995, and a far higher, but unknown, proportion of lending of 7 years or longer. MUFIS-sponsored loans also helped increase competition in municipal lending. They financed two-thirds to three-fourths of all long-term municipal lending by other than the dominant bank in the municipal sector.

5.10 The aggregate shift from short term to long term credits has been accompanied by a lowering of interest rates. At the beginning of 1993, long-term municipal loans and municipal bonds carried interest rates in the range of 14% to 16%. At the end of 1995, these interest rates stood in the range of 11.2% to 12%.

5.11 The decline in interest rates for municipal loans has been steeper than the decline in other lending rates throughout the Czech economy. This reflects the improvement in creditworthiness of municipalities as a result of their high rates of timely loan repayment. Table 18 shows the gradual decline in average interest rates on all bank loans, by year. One phenomenon of the Czech market is that long-term interest rates for highly creditworthy borrowers often are no higher -- and sometimes lower -- than interest rates on medium-term loans. This inverted yield curve results from the widespread expectation that inflation rates will continue to fall.

Table 18
Average Interest Rates in %

	All Bank Loans	Discount Rate
1993 (annual)	14.1	8.00
1994 (annual)	13.1	8.50
1995 (III quarter)	12.9	9.50

5.12 The Ministry of Finance reports that about 850 municipalities have borrowed from commercial banks, or about 14% of all municipalities in the Czech Republic. The Czech Savings Bank alone reports that it has provided more than 900 different municipal loans since 1992, with a "problem loan" rate of less than 1%.

5.13 Although the municipal commercial loan market has been developing rapidly, its total share in the Czech credit market remains low. Table 19 demonstrates that municipal credit has been growing far more rapidly than the rest of the credit market, and that long-term bank credits have been growing especially fast in the municipal sector. Long-term municipal credit (4 year loans or longer) doubled between 1994 and 1995 in the municipal sector, while increasing by only 5.6% for the economy as a whole.

5.14 Still, the municipal share of all commercial bank credit was only 0.9% at the end of December 1995. Municipal credit was a somewhat more significant factor in long-term lending. Municipalities' long-term debt accounted for 1.4% of all long-term debt to domestic commercial banks. As a point of comparison, outstanding municipal credits (both loans and bonds) represented 8.5% of outstanding domestic credits (loans and bonds) during the period 1993-95 in the United States.[3]

Table 19
Growth of Commercial Bank Credits, between December 31, 1994 and December 31, 1995 in Kc (billion)

	1994	1995	% Growth
Total	**784.0**	**836.7**	**6.7%**
Non-Financial Organizations	593.9	643.5	8.4%
Local Government	4.2	7.3	73.8%
Total Long-Term (4+ years)	**237.0**	**250.3**	**5.6%**
Non-Financial Organizations, Long-Term	157.3	170.8	6.9%
Local Government, Long-Term	1.8	3.6	100%

The overall structure of the Czech credit market is quite different from that in the United States. Central government debt is a tiny proportion of the total (1.1%), because of the Government's balanced budget record. Large borrowers -- like the biggest banks, the national electric company (CEZ), and the city of Prague -- have borrowed from the non-domestic European market. Home mortgage borrowing has just begun.

Table 20
Structure of Commercial Bank Credits Outstanding According to Type of Borrower as of December 31, 1995 (Kc billion)

	Short Term[a]		**Medium Term[b]**		**Long Term[c]**		**Total**	
	Kc (bill.)	**%**	**Kc (bill.)**	**%**	**Kc (bill.)**	**%**	**Kc (bill.)**	**%**
Total	345.8	100.0	240.6	100.0	250.3	100.0	836.7	100.0
Non-financial organizations	289.4	83.7	183.3	76.2	170.8	68.2	643.5	76.9
Monetary & in- surance organiz.	13.1	3.8	10.3	4.3	0.6	0.2	24	2.9
Governmental sector from it:	2.5	0.7	2.1	0.9	11.5	4.6	16.1	1.9
Central government	0.7	0.2	0.2	0.1	7.9	3.2	8.8	1.1
Local government	1.8	0.5	1.9	0.8	3.6	1.4	7.3	0.9
Non-profit organizations	1.0	0.3	0.5	0.2	25.7	10.3	27.2	3.3
Self employees	19.4	5.6	35.5	14.8	11.4	4.6	66.3	7.9
Population	1.9	0.5	5.7	2.4	27.9	11.0	35.5	4.2
Other	18.5	5.4	3.2	1.3	2.4	1.0	24.1	2.9

a. Less than 1 years.

by information on the size of individual bond issues approved for sale in 1996, which range from Kc 200 million to Kc 1.5 billion.

5.17 There is no official overview of municipalities' foreign loans. According to Ministry of Finance estimates, municipalities' foreign debt (excluding the Prague bond issue) is less than Kc 600 million.

5.18 **Subsidized State Lending.** An important part of municipal borrowing consists of interest-free loans granted by the State Environmental Fund, Ministry of Agriculture and Ministry of Finance. These loans have the character of "reimbursable financial assistance." The State Environmental Fund started to grant such loans in 1993, the Ministry of Finance and the Ministry of Agriculture in 1994. These loans can only be granted for specific types of investments. The State Environmental Fund provides loans to municipalities for conversion of heating systems, solution of the household solid waste-handling problem, waste-water treatment plants and sewage systems. The Ministry of Agriculture grants loans for construction of water-distribution systems, drinking-water treatment plants, construction of sewage systems and waste-water purification plants. The Ministry of Finance provides reimbursable financial assistance for construction of major water-development projects, for reconstruction or construction of public facilities (schools, hospitals), for modernization and construction of housing, and for rural revitalization of countryside. The volume of zero-interest lending by the State is summarized in Table 22.

5.19 The payment schedules of these interest-free loans vary. The most common loan conditions call for annual principal repayments for 10 years, commencing at the time of project completion, or in the case of the Environmental Fund, a five-year grace period on payments followed by five years of equal principal repayments. A third way of paying off reimbursable financial assistance is a one-time payment after 10 years. Considering the fact that these types of loans are new in the Czech Republic, we can presume that essentially all loans that have been made remain outstanding. Only a handful of such loans have had payments due. These are primarily loans from the Environmental Fund, which initially had a three-year grace period.

Table 22
Zero Interest Loans Provided to Municipalities in Kc (billion)

	1993	1994	1995	1993-1995
Ministry of Finance	0.0	0.5	1.5	2.0
Ministry of Agriculture *	0.0	0.2	0.6	0.8
State Environmental Fund	0.8	1.4	1.5	3.7
Total	**0.8**	**2.1**	**3.6**	**6.5**

* This amount includes only reimbursable financial assistance granted directly to municipalities and cities. The Ministry of Agriculture also provides reimbursable financial assistance to voluntary unions of municipalities and to joint-stock water companies, where the municipalities are the majority owners. Including these loans, the total amount of interest-free loans then reaches 0.4 billion crowns in 1994 and 1.0 billion crowns in 1995.

5.20 The overall structure of municipal debt in the Czech Republic is shown in Table 23. These figures were specially compiled for this report. Neither the Ministry of Finance nor any other source regularly publishes such data.

Table 23
The Structure of Municipal Outstanding Debt in Kc (million)

	1993		1994		1995	
	Kc(mill.)	%	Kc(mill.)	%	Kc(mill.)	%
Commercial credits	1,983.4	70.5	4,222.4	28.1	7,330.2	32.7
Bonds	28.5	1.0	7,897.8	52.6	8,557.8	38.2
Zero-interest loans	800.0	28.5	2,900.0	19.3	6,500.0	29.0
Total	**2,811.9**	**100.0**	**15,020.2**	**100.0**	**22,388.0**	**100.0**

5.21 As can be seen from Table 23, total municipal debt grew rapidly over the period 1993-1995. The total volume of debt outstanding increased by eight times during these three years. All segments of the municipal credit market have shown dramatic growth, though the magnitude of the Prague bond issue tends to distort more detailed comparisons. The very rapid expansion of zero-interest lending is noteworthy. It represents implementation of a state policy to subsidize environmental and other specific investments that carry national priority. The low-cost loans do not constitute general purpose subsidies to municipalities because they are in need of financial assistance.

5.22 To a substantial extent, interest-free state loans have replaced state grants and direct state financing of local infrastructure investment. The share of all kinds of subsidies in local budgets has continued to decline since 1993, while the role of commercial borrowing and own-source revenues has increased. This global picture is summarized in Table 24.

Table 24
Share of Subsidies and Borrowings in Local Budget Revenue
(Excludes Prague Bond)

	1993		1994[d]		1995	
	Kc(bill.)	%	Kc(bill.)	%	Kc(bill.)	%
Total Subsidies[a]	27.9	27.5	30.2	25.3	34.9	23.4
Zero-Interest Loans	0.8	0.8	2.1	1.8	3.6	2.4
Commercial Borrowing[b]	2.1	2.1	4.2	3.5	6.7	4.5
Own-Source Revenue	70.5	69.6	83.0	69.4	103.7	69.7
Total Revenue [c]	**101.3**	**100.0**	**119.5**	**100.0**	**148.9**	**100.0**

a. Includes grants and other subsidies.
b. Includes both municipal loans and municipal bonds.
c. Borrowing is included as "revenue."
d. Excludes Prague bond issue. With Prague bond issue included, the totals for 1994 are:

	Kc (bill.)	%
Subsidies	30.2	23.8
Zero-Interest Loan	2.1	1.7
Borrowing	11.5	9.1
Own-Source Revenue	83.0	65.4
Total Revenue	126.8	100.0

5.23 **The Financing of Municipal Infrastructure Investment .** Municipal capital expenditures grew steadily from 1993 to 1995, both in real terms and as a percentage of local budgets (see Table 25). The Czech Republic is the only country in Central and Eastern Europe where local investment has increased in this manner. There are signs, however, that the investment share of municipal budgets is now stabilizing.

Table 25
Capital Investment Share of Aggregate Municipal Budgets

	Kc (bill.)		
	1993	**1994**	**1995**
Expenditure	90.2	112.1	132.3
From it: Investment expenditure	31.6	42.4	50.9
Investment share in total expenditure	35.1%	37.8%	38.4%

5.24 Municipal capital investment consists of three basic components. The first is own investment construction. The second is capital transfers to help finance construction by other local entities, primarily contributory organizations. The third is "associated financial means" or contributions to investment projects carried out jointly by an association of municipalities. Between 1993 and 1995 capital transfers grew as a share of municipal capital investment, primarily because a number of municipal entities were transformed into quasi-independent contributory organizations.

Table 26
Structure of Municipal Capital Investment

	1993		1994		1995	
	Kc (mill.)	**%**	**Kc (mill.)**	**%**	**Kc (mill.)**	**%**
Direct Investment	29,480.8	93.2	33,990.6	80.2	41,718.5	82.0
Capital Transfers for Investment	2,139.1	6.8	7,828.8	18.5	8,702.1	17.1
Associated Means		0.0	585.2	1.4	441.0	0.9
Total	**31,619.9**	**100.0**	**42,404.6**	**100.0**	**50,861.6**	**100.0**

5.25 It is difficult to fully separate out the sources of financing for local investment because separate capital budgets are not used in the Czech Republic. The data reported below are based on certain assumptions:

- All commercial loans and interest-free credits, regardless of their time structure, are assumed to be used for financing investment construction in the year they are received.

- Municipal bond proceeds are assumed to finance investment in different years. Each municipality issuing bonds was contacted to determine the time profile over which it invested the bond proceeds.

- Capital subsidies consist of specific grants for capital construction as well as the capital share of functional transfers and regional equalization transfers. These are assumed to be invested in the years that they are received.

A separate paper provides further detail on how capital financing sources were estimated.[4]

5.26 Tables 27 and 28 provide an overview of the sources of municipal capital investment financing. They show that the share of investment financed by both commercial and state-subsidized, zero-interest debt has been rising steadily, while the shares of other financing sources have fluctuated, but generally declined. In particular, the share of capital investment financed from own resources fell steeply in 1995. Over the entire period, the relative importance of capital subsidies from the state also declined substantially. However, the state share in local capital financing rebounded somewhat in 1995, as the state increased its participation in the financing of local hospitals, schools, water and waste-water projects, and transportation. The largest growth came from financing provided by the National Property Fund. In effect, this represents a realignment of the state's investment portfolio. The proceeds from privatization sales were used in part to co-finance local infrastructure investment.

5.27 Because of the importance of Prague's capital expenditure and borrowing in local sector totals, Table 27 summarizes the sources of capital financing for all municipal investment, while Table 28 shows the comparable totals for municipalities excluding Prague. The general trends are the same. However, state subsidies and zero-interest debt figure more prominently in capital financing outside Prague.

Zdena Matouskova, "The Municipal Credit Market and Municipal Infrastructure Financing" (April 1996).

Table 27
Municipal Infrastructure Financing (including Prague)

	1993		1994		1995	
	Kc (mill.)	%	Kc (mill.)	%	Kc (mill.)	%
Investment Expenditure	31,619.9	100.0	42,404.6	100.0	50,861.6	100.0
Financing Sources: Capital Subsidies	15,663.3	49.5	14,268.4	33.6	19,066.1	37.5
Commercial Debt*	2,159.5	6.8	5,493.3	13.0	9,156.1	18.0
Zero-interest Debt	800.0	2.6	2,100.0	5.0	3,600.0	7.1
Own Resources	12,997.1	41.1	20,542.9	48.4	19,039.4	37.4

* Commercial debt includes bond proceeds allocated as described in Section 5.25.

Table 28
Municipal Infrastructure Financing (excluding Prague)

	1993		1994		1995	
	Kc (mill.)	%	Kc (mill.)	%	Kc (mill.)	%
Investment Expenditure	24,188.6	100.0	31,883.8	100.0	39,965.9	100.0
Financing Sources: Capital Subsidies	12,432.0	51.4	12,489.3	39.2	16,925.9	42.4
Commercial Debt*	2,083.1	8.6	3,789.8	11.9	6,680.2	16.7
Zero-interest Debt	800.0	3.3	2,100.0	6.6	3,600.0	9.0
Own Resources	8.873.5	36.7	13,504.7	42.4	12,759.8	31.9

* Commercial debt includes bond proceeds allocated as described in Section 5.25.

VI. POLICY OBJECTIVES AND POLICY IMPACTS

6.01 One of the important innovations contained in the Program Agreement between the Czech Republic and the United States is Annex B, the Policy Action Plan. This Annex spells out the “mutual institutional and sectoral goals” that the parties propose to pursue through the program. It identifies specific policy objectives for the sector, and specific indicators to measure progress toward meeting those objectives. The Policy Action Plan has been given a central role in program implementation, because the purpose of the Program is to institutionalize a well-functioning credit market that complements the rest of the Czech system for financing local governments.

6.02 This section identifies each of the original policy Objectives and the Indicators that it was agreed would be used for measurement purposes. It assesses progress toward meeting each element of the Policy Action Plan.

6.03 The Program Agreement specifically recognizes that the policy objectives of the Program should be met through several lines of activity. The municipal loans by MUFIS through HG funds are intended to directly embody the policy objectives. The technical assistance provided by USAID is intended to help equip Czech institutions to achieve these objectives on their own, as well as through MUFIS. Finally, Czech institutions of all kinds are rapidly maturing through their own learning as well as through technical assistance from other parties and market dealings with financial institutions in the West.

6.04 **Objective 1: A Functioning Borrower (MUFIS) that is financially sound and that stimulates and encourages non-governmental lending to local governments for sustainable infrastructure projects.**

6.05 The agreed- upon indicator for this objective is an institution that is “properly staffed, housed, equipped, having established regulations, policies, and procedures and having made one or more loans to Participating Institutions for infrastructure projects.”

6.06 MUFIS is fully functioning. It has disbursed almost 90% of the funds received in the first tranche of the HG loan. It has not implemented the staffing recommendations of the technical assistance plan, but has relied on CMGDB personnel to provide financial and management services. As noted in the body of this report, MUFIS generated unexpectedly large operating losses in 1995. About half of these losses resulted from income tax withholding which MUFIS was subject to despite its overall loss position. Part of the remainder was due to accounting adjustments. However, MUFIS displayed a passive attitude toward cash management. The establishment of “financially sound” operating procedures should be a top priority for 1996.

6.07 **Objective 2: Demonstration that properly designed municipal lending involves acceptable credit and business risks and that it therefore is financially sound for banks and other private financial sector institutions to increase municipal lending from their own resources, subject to normal market considerations.**

6.08 One agreed-upon indicator for this objective is a good record of MUFIS loan repayment, the goal for which is quantified in Annex B of the Program Agreement. All of the loan payments due to MUFIS by banks and to participating banks by municipalities have been made in full and on time. The standard of performance therefore has been met in full (and exceeded). However, as previously noted, only five out of 23 MUFIS loans had payments of both interest and principal due as of December 31, 1995; therefore, most of MUFIS´ loan repayment experience lies in the future. Interest has been paid on time by all nineteen municipalities which have had payments due. All of MUFIS´ loans to date appear to reflect prudent levels of indebtedness, both for the individual loans and for the overall debt structure of the borrowing municipalities. However, some of the borrowing municipalities may not be anticipating the full weight of Environmental Fund loan repayments that will begin in the future.

6.09 More importantly, there have been no defaults reported on <u>any</u> commercial municipal credits in the Czech Republic, despite the very rapid growth in municipal lending. Ceska Sporitelna, the largest lender to municipalities, reports that less than 1% of payments are 30 days or more past due. The Czech National Bank has classified municipal debt as the second safest category of debt in the country, trailing only the debt obligations of the State. Indeed, this exemplary record with respect to repayment is largely responsible for the increasing volume of market- based loan activity. This Program policy objective has also been met in full and exceeded.

6.10 Nonetheless, there are signs of increased risk in municipal lending. In particular, the repayment rate on State subsidized loans is poor. The Environmental Fund estimates that as much as 30% of its loans may not be repaid in full and on time. Such a poor repayment record could infect the commercial credit market, if municipalities come to believe it is not obligatory to meet debt service. There have been reports -- which this study was unable to confirm -- that at least one municipal bond issue had to draw on the guaranty of the underwriting bank to meet its full payments.

6.11 **Objective 3: A substantial increase in the annual levels of commercial lending to the local government infrastructure sector from all non-governmental sources, both in absolute terms and relative to central government investment subsidies for local government investment.** The intent behind this objective was to encourage substitution of market-rate capital borrowing for central government subsidies in financing part of local investment.

6.12 The agreed-upon indicators for this objective were that:

(a) Annual non-governmental lending [to municipalities] should exceed US $20 million equivalent by the end of 1995.

(b) Commercial-rate credit should grow faster than central government subsidies as a source of financing for local government capital spending, using 1993 as a baseline.

6.13 As detailed in Tables 27 and 28 of the report, the volume of non-governmental lending greatly exceeded the Program target. However, commercial credit and central government subsidies have kept pace with each other.

6.14 **Objective 4: Demonstration of increased municipal capital investment in basic infrastructure.**

6.15 The agreed-upon indicator for Objective 4 is a 10% per annum increase in the real level of local government capital investment. As demonstrated in Part V, this goal has been met in full and amply exceeded. Czech municipalities started the period with the highest share of local budgets devoted to capital investment of any of the countries of Central and Eastern Europe, and have been able to increase their investment share.

6.16 **Objective 5** of the Policy Action Plan differs in character from the other objectives and indicators, in that it involves qualitative assessments of municipalities' and banks' financial practices: **Demonstration of improvement in the budgeting and financial management capabilities of local governments and in the quality of infrastructure project preparation, especially as regards market-demand and cost recovery studies. Improvement in the financial appraisal of municipal loan applications by banks and other financial institutions.**

6.17 The agreed upon indicator for Objective 5 is a qualitative assessment of change in municipal budgeting procedures and change in bank loan appraisal procedures.

6.18 No general assessment has been conducted of baseline or current budgeting practices in Czech municipalities. Without systematic information, it is impossible to generalize about the improvements in financial management and budgeting that may have occurred in the universe of Czech municipalities.

6.19 It is clear, however, that the quality of financial preparation for infrastructure projects financed through MUFIS has greatly improved over previous practice. All participating municipalities reported that they provided and analyzed for their own planning purposes the financial information identified in the Project Preparation Guidelines prepared by the Urban Institute and distributed by USAID. This analysis includes projecting future municipal revenues, future debt repayment obligations, and the burden of debt servicing in the municipality's overall budget. For many of the municipalities participating in the MUFIS program, the loan application process represented the jurisdiction's first attempt at a multi-year projection of financial obligations. Note, however, that in two of the municipalities that have borrowed through MUFIS, debt service exceeds the 10% of expenditures recommended by the Guidelines. The USAID Program is now collaborating with the Union of Towns and Cities to introduce a more complete and more sophisticated set of financial indicators for municipal budget management.

6.20 All of the banks making loans under the MUFIS program have introduced new methods of credit assessment for municipal lending. All have participated in two rounds of Program seminars on assessing municipal creditworthiness and loan evaluation.

ANNEX A

SUMMARY DATA ON INDIVIDUAL MUNICIPAL LOANS

UNDER MUFIS PROGRAM

REALIZED PROJECT			Amount	Amount	Maturity	Interest	Name of the Bank	Number of Households	Number of Households %
	Municipality	Project	Kc(000)	US$(000)	Years	Rate (%)			
1.	Bruntál	metering-heating	10,153.0	391.6	10	11.5	COOP Brno, a.s.	3,100	55
2.	Vratimov	co-generation for residential heating	40,000.0	1,542.7	14	11.5	COOP Brno, a.s.	650	30
3.	Bu_ovice	gas installation water distribution	20,000.0	771.4	14	11.5	COOP Brno, a.s.	1,150	50
4.	Opava	metering-heating	22,500.0	867.8	15	11.0	COOP Brno, a.s.	3,100	15
5.	Bystøi_ka	gas installation	10,000.0	385.7	10	11.5	COOP Brno, a.s.	220	65
6.	Jablùnka	gas installation	10,000.0	385.7	10	11.5	COOP Brno, a.s.	370	55
7.	Tøebí_	infrastructure reconstruction	40,000.0	1,542.7	14	11.5	COOP Brno, a.s.	450	5
8.	Kralupy	gas installation	26,630.0	1,027.1	14	12.0	KB, a. s.	850	15
9.	Vítkov	solid waste landfill	12,000.0	462.8	10	12.0	KB, a.s.	6,600	100*
10.	Pardubice	infrastructure reconstruction	22,000.0	848.5	10	11.0	KB, a.s.	4,500	15
11.	Svatava	gas installation	12,000.0	462.8	15	12.0	KB, a.s.	350	75
12.	Frýdlant	co-generation for residential heating	45,360.0	1,749.5	14	12.0	KB, a.s.	1,100	45

13.	**D. Domaslavice**	**gas installation**	**10,000.0**	**385.7**	**15**	**12.0**	**KB, a.s.**	**320**	**100**
14.	**Slavkov u Brna**	**infrastructure reconstruction square reconstruction**	**19,000.0**	**732.8**	**15**	**12.0**	**IPB, a.s.**	**1,200**	**60**
REALIZED PROJECT			**Amount**	**Amount**	**Maturity**	**Interest**	**Name of the Bank**	**Number of Households**	**Number of Households %**
	Municipality	**Project**	**Kc(000)**	**US$(000)**	**(Years)**	**Rate (%)**			
15.	**Jesenice**	water distribution	17,000.0	655.7	14	12.0	IPB, a.s.	850	100*/
16.	**Slavkov u Opavy**	sewer collection and treatment	10,000.0	385.7	10	12.0	IPB, a.s.	550	100
17.	**Mikulovice**	water distribution gas installation	10,500.0	405.0	10	12.0	IPB, a.s.	950	100
18.	**Prùhonice**	sewer collection and treatment	15,000.0	577.4	15	12.0	IPB, a.s.	1,200	100*/
19.	**Nýdek**	water distribution sewer collection gas installation	13,000.0	501.4	10	12.0	PGB, a.s.	450	70
20.	**D. Koulnice**	water distribution gas installation	15,000.0	577.4	15	12.0	PGB, a.s.	750	100
21.	**Bystrice p/Hostýnem**	sewer collection and treatment metering-heating	18,000.0	694.2	10	11.5	PGB, a.s.	3,650	100*/
22.	**Ledeè n/Sázavou**	sewer collection and treatment	25,000.0	964.2	10	11.75	PGB, a.s.	2,200	100

23.	**Velké Losiny**	sewer collection gas installation	25,000.0	964.2	15	12.0	PGB, a.s.	850	85
TOTAL			**448,143.0**	**17,282.0**					

* Project serves neighboring municipalities as well.

ANNEX B
Municipal Bonds in the Czech Republic

Municipality	Year of Issue	Maturity (years)	Amount in Kc (mill.)	Interest in %	Underwriter
Ostrava[a]*	1992	6	8.5	d+1-5%	City Hall Itself
Šumperk	1993	5	20.0	18	_sl. obchodní banka
Smr_ovka[b]	1994	7	115.0	14.25	_eská sporitelna
Liberec	1994	5	100.0	14.25	_eská sporitelna
Praha	1994	5	7,294.3	7.25	Nomura International
Pardubice	1994	5	50.0	12.7	Komercní banka
Ústí nad Labem	1994	5	150.0	12.7	Komercní banka
_áslav	1994	8	90.0	15.5	Burzovní spolecnost pro kapitálový trh
Rokytnice n / Jizerou[c]	1994	7	120.0	12.0	_eská sporitelna
Veselí nad Moravou	1994	7	10.0	14.1	Velkomoravská banka
Rychnov nad Knì_nou	1995	7	100.0	13.1	Komercní banka
Plzen[d]	1995	5	300.0	11.5	Bayerische Vereinsbank AG-Praha, ING (C.R.) Capital Markets CS First Boston (Praha) Komercní banka
Mariánské Láznì	1995	5	200.0	11.5	Komercní banka
Brno	1996	7	1,200.0	11.1	Investicní a poštovní banka

a. Ostrava paid off their bonds in 1995.

b. Smr_vka issued only the first tranche of the bonds and the municipality does not intend to issue the second tranche in 1996.

c. Rokytnice issued the first tranche (Kc 60 million) in 1994 and the second tranche (Kc 60 million) in 1995.

d. Plzen issued only the first tranche (Kc 300 million), the total amount of approved bonds is Kc 500 million.

Total municipal bonds issue: Kc 9,757.8 million (excluding Prague: Kc 2,463.5 million).
Total outstanding bonds: Kc 9,749.3 million (excluding Prague: Kc 2,455 million).

Expecting municipal bond issue in 1996: Ostrava - Kc 1,350 million; Kladno - Kc 250 million; Karlovy Vary - Kc 200 million.